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TREASURY FOR D.PETERS, R.HALL
USAID FOR C.GARRETT, S.SWIFT
AMEMB ACCRA FOR USAID P.RICHARDSON,K.MCCOWN
AMEMB DAKAR FOR FCS S.MORRISON, FAS R.HANSON

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TAGS: ECON EFIN IDA IMF PGOV PREF USTR EITI IV
SUBJECT: COTE D'IVOIRE ADOPTS BUDGET ON TIME; IMF, WORLD BANK CAUTIOUSLY ACCEPT KEY STEP, BUT DESCRIBE GOVERNMENT'S DISCRETIONARY SPENDING AS "OUT OF CONTROL"

REF: MASSINGA-RICHARD HALL JANUARY 17 UNCLASSIFIED

EMAIL

Classified By: EconChief EMassinga, Reasons 1.4 (b,d)

¶1. (C) Summary. Cote d'Ivoire adopted its 2008 budget in late December 2007, fulfilling a key demand from the international financial institutions engaged in ongoing assistance negotiations with the government. The budget is 8.5 percent higher than that of 2007, reflecting higher personnel costs as well as expansion of expenses related to ending the five and a half year-old political crisis. Revenues are projected to rise with the growth in the economy, but serious shortcomings in revenue accounting related to oil persist. The Ministry of Finance will be hard-pressed to meet its financial obligations by February to end the long-standing arrears to the World Bank and African Development Bank, and this problem could be exacerbated if receipts from the government's settlement of the 2006 toxic waste scandal have been improperly spent. Without settlement of arrears, reaching a decision point to slash the country's high indebtedness could be delayed into 2009. International financial institutions identify bloated, out-of-control discretionary spending by the Presidency and incompetent management of international assistance offers by the Prime Minister as key issues hindering the government's ability to finance the actions needed to end the political crisis. End Summary.

The 2008 Budget Is Adopted

¶2. (SBU) Cote d'Ivoire adopted its fiscal 2008 year budget on December 28, 2007, representing a key step in its multi-step process to normalize its relationship with the international financial institutions (the so-called IFIs: the World Bank, IMF and African Development Bank). The Council of Ministers adopted the budget on time, in contrast with the 2007 budget, which was adopted in May 2007, thus allowing a substantial portion of that year's expenditures to be disbursed outside of normal fiscal controls and outside of the watchful eye of the IMF's Abidjan mission. The IFIs had made on-time adoption of the 2008 budget a pre-requisite for continuing loans, assistance, and negotiation towards eventual multilateral debt forgiveness under the Highly Indebted Poor Country (HIPC) initiative.

¶3. (U) The 2008 budget target is 8.5 percent higher than that of 2007, up to USD 4.8 billion. The budget counts on 2.9 percent GDP growth to finance a portion of the expenditure increase, up from 1.7 percent in 2007, relying on increased exports of agricultural goods and oil, and growth in the service sector. Projected revenues are USD 3.9 billion, with a deficit to be financed of USD 873 million. The budget projects higher corporate, VAT, customs and oil tax revenues, with an additional USD 200 million in revenue from redeploying the country's administrative structures (customs, income tax inspectors, etc.) in the formerly rebel-held north.

¶4. (U) Higher spending comes from the ongoing high costs of servicing the country's debt (over USD 1.2 billion to finance domestic bonds, pay back arrears to IFIs and to keep current with IFI debt, along with other miscellaneous loans) and USD 1.5 billion for personnel costs (up 11.4 percent over 2007 figures due to wage concessions to unions in the health care and educational sectors, as well as continuing rises in the costs of maintaining the armed forces). The budget calls for USD 374 million for special spending to end the political crisis: USD 63 million for demobilization, USD 48 million for the redeployment of the country's administration to the north, USD 109 for the country's identification process, USD 86 million to cover election costs and USD 68 million to pay for the country's new "civic service" program designed to absorb youth currently in the military, militias and rebel Forces Nouvelles who are not slated to be integrated into the country's new armed forces.

World Bank Views on the Budget, Long-Term Debt Relief

¶5. (C) During a January 16 meeting between the Charge and

World Bank Country Manager Bernard Harbone and key members of his staff, Harbone stated that the period running up to early February is a "tense time." Harbone said Cote d'Ivoire's arrears clearance, originally scheduled for late January, has been postponed until approximately February 13, at which point the government will have to pay the balance of its promised USD 240-250 million to finally clear its arrears to the Bank. Once it does so, the WB's IDA will pay the remainder (USD 240-250 million). The government has paid USD 90 million thus far, but has to come up with the remaining USD 160 million. The Ministry of Finance, as seen in the 2008 budget and in the latter half of 2007, is experiencing upward pressures on its resources, making reaching the goal by February 13 increasingly difficult.

¶6. (C) Harbone participated in the January 14 meeting attended by President Gbagbo and Prime Minister Soro in Ouagadougou at which the WB representative raised with all the key interlocutors the central issue of the discretionary budgets of the President and Prime Minister. These two accounts (which do not appear in the basic spreadsheet accounting of the budget) are "substantially" inflated over 2007 levels and put additional constraints on the Finance Ministry's ability to finance the end of crisis and "civic service" budgets. OPA Facilitator President Compaore, along with Gbagbo and Soro, appear to have taken the critique on board, but do not seem to have changed fundamental budget policy.

¶7. (C) Harbone said that Cote d'Ivoire had achieved 90 percent of the reform conditions necessary for the IDA to pay its half of the arrears bill when the February vote comes up. Cote d'Ivoire is on track to create its Extractive Industries Transparency Initiative civil society consultative bodies (necessary for the country to be accepted into the initiative, which is, according to Harbone, now a precondition for continued IFIs engagement). The IFIs' multiple audits of the cocoa and petrol sector are completed or nearly so. According to Harbone, while a great deal of

analytical work remains to be done, the basics are in place.

¶8. (C) Harbone and his deputy, Richard Doffonsou, noted that energy issues remain vexingly difficult to assess in the government's budgets, both 2007 and 2008. While two of the three energy-related audits are complete (and supposedly available to ED offices in Washington), neither the completed ones nor the last one in draft show a clear picture of the fiscal structure of the sector. Harbone said the USD 150 million in petroleum-related taxes from 2007 were "what the government wanted us to see" and don't necessarily reflect the government's true receipts. He said the same is true for the USD 280 million projected in petroleum-related taxes in the 2008 budget. The government told the IFIs it will conduct its own petroleum audit, but that it will not be made public; however, that audit will be part of the EITI process, which raises the question of whether the IFIs and EITI itself would be able to make it publicly available.

¶9. (C) Harbone was more upbeat about the government complying with demands for more transparency in the cocoa sector and the sector's relation to the country's fiscal management. The IFIs have already won a reduction in the country's taxes raised to support the four "cocoa bodies" created in the 1998-1999 cocoa liberalization (nearly USD 900 million has been collected through these special taxes since 2001, with little in the way of rural infrastructure or other benefits for cocoa farmers to show for it) and are driving for further modest reductions in the years ahead. The next target in 2009 and beyond on the cocoa agenda will be the so-called "unique right to export" (DUS in French) tax, which is nearly USD .50 per kilo and is identified as a major factor in depressing cocoa farmer income relative to that seen in Ghana and other cocoa-growing countries.

¶10. (C) Harbone turned to the question of the HIPC decision point. He expressed surprise at discussion in Washington about reaching a decision point by the summer of 2008, arguing that for that to happen, the IMF's Emergency Post Conflict Assistance Package (EPCA) must be on track, as well as the AfDB arrears clearance (those arrears stand at nearly USD 570 million). Harbone said that additionally, the

Ivorian Poverty Strategy Reduction Paper would have to be complete, along with the strict WB-imposed process of consulting widely with civil society and its associated examination of respect for human rights and good governance. Harbone noted the IFIs would naturally look at the status of elections. He explained that while elections per se wouldn't be a prerequisite for HIPC, in practice, successful elections would be an important factor in moving forward.

¶11. (C) Harbone touched on the Prime Minister's failure to draw upon the WB's USD 120 million Post Conflict Assistant Package, provided in July 2007 to, inter alia, jump-start the disarmament process, support rural infrastructure projects and help the identification program. Those funds could have been accessed since July, along with USD 104 million in old WB programs now available, if the government had adhered to relatively simple requirements. A key requirement is the establishment of an office to direct the post-crisis spending. The PM has been very slow to set up the office in the correct manner, and did not sign the decree creating this office according to the established rules until January, 2008; recruitment has not yet begun.

IMF Offers Sharp Commentary on the Budget

¶12. (C) The Charge met with IMF Country Director Phillipe Egoume on January 17, and discussed the budget in the context of the IFIs' ongoing engagement in Cote d'Ivoire. Egoume confirmed that the country's GDP should rise by 2.9 to 3 percent in 2008, up from 1.7 in 2007, as predicted in the budget, and cited the rebound in private investment,

propelled by improved investor confidence in the peace process, as the reason. Sounding a serious note of caution, however, Egoume said that endemic corruption acts as a serious break on the economy's long-term potential, and undermines proper fiscal management and tax collection. Egoume accused Lebanese traders, for example, of openly defying the country's tax laws with the connivance of corrupt officials.

¶13. (C) Egoume said that cocoa and other agricultural exports are doing reasonably well, propping up their portions of the country's tax base. He noted that inflation is moderate and under control and even the country's endemic roadblocks are gradually loosening their grip on the country's economy, adding to gradually falling costs for transporting goods. According to Egoume, coffee production is up strongly and international prices are higher, leading to better tax receipts. Egoume said the cocoa sector is still seeing substantial transshipment to Ghana, leading to that country coming close in 2008 to Cote d'Ivoire's overall cocoa export figures. Egoume cautioned that while 3 percent GDP growth is good, it is only good enough for per capita income to hold steady, given population growth. Egoume said that the IFIs have won approval from the government to force the cocoa regulatory bodies to countersign any investments with the IFIs, a measure that IFIs hope will improve the cocoa bodies' management and transparency.

¶14. (C) Reviewing the 2007 budget, Egoume said he and his staff worked closely with the Ministry of Finance to keep expenditures in line with budgeted projections and to maintain the country's planned primary fiscal surplus of one percent (which excludes foreign financing). Egoume said 2007 revenues stayed within projections (aside from oil, which produced less revenue than had been anticipated) but that some expenditures overshot their targets. Discretionary spending by the Presidency and Prime Minister's Office (particularly the former) greatly exceeded initial projections. Egoume said that by the end of September, 2007 (with another quarter to go in the rest of the fiscal year), the Presidency's expenditures were over USD 115 million, whereas the budget called for USD 80 million for the whole year. According to Egoume, Presidential personnel costs alone through September 2007 were USD 50 million vs. a projected USD 23 million for the full year. Egoume explained these overruns negatively affected the ability of the Finance Ministry to pay for measures designed to end the political crisis as well as for needed social expenditures. Government expenditures for education, for example, were USD

400 million through September 2007, versus a projected 650 million for the whole year; health care costs were USD 115 versus a projected USD 200 million; and agriculture spending was a scant USD 20 million against a planned USD 60 million in full year spending. In sum, while the budget was balanced, the excessive spending by the Presidency came at the expense of critically needed spending in the social sector.

¶15. (C) Egoume related the fear that the government's holdings in the Central Bank do not add up. Specifically, the USD 100 million in left-over receipts from the USD 190 million toxic waste settlement with European company Trafigura do not appear to be in the government's accounts at the Central Bank. The IMF is investigating this, but if that money was spent outside of normal fiscal controls, the resulting budget hole would probably prevent the government from financing its portion of the WB arrears clearance by February, and thus delay Cote d'Ivoire's whole package of assistance and budget support from the IFIs. Asked if the government could borrow sufficient cash to make up the potential shortfall, Egoume said that banks in the region were coming up against their limits on how much government paper they can hold as Cote d'Ivoire's recent aggressive borrowing has taken its toll and that regional liquidity is

suffering as a result.

¶16. (C) Egoume praised the government for passing the 2008 budget on time. He said that all expenditures would thus go through the Ministry of Finance's rigorous internal control system, rather than the rather lackadaisical system of extra-budgetary expenditures the government uses when a budget is not in force. Egoume was particularly pleased that the IMF's demand for a detailed quarterly budget status report, prepared by the Ministry of Finance (and overseen by the IMF) was (grudgingly) accepted by the government. This report will be provided to all Ministries through the Council of Ministers and will eventually be published, greatly complicating efforts to manipulate the budget for political ends.

¶17. (C) Comment: The adoption of the budget is a good step in the direction of more sound fiscal management and readiness to engage seriously with the international financial community to fashion the means needed to end the political crisis and set the stage for more durable long-term growth. However, serious questions remain concerning the ability of the Prime Minister to manage the economic portfolio, the oversized Presidential budget, the accuracy of reporting of fiscal receipts and whether the government is honestly accounting for the toxic waste settlement funds. These questions combine to call into serious question whether the HIPC decision point can be reached by the summer of 2008, or even by the end of the year. End Comment.
AKUETTEH